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Bank of Finland

## **Euro area outlook and monetary policy**

ECB monetary policy strategy needs to be reviewed

Bank of Finland press conference 15 March 2019





## Topics

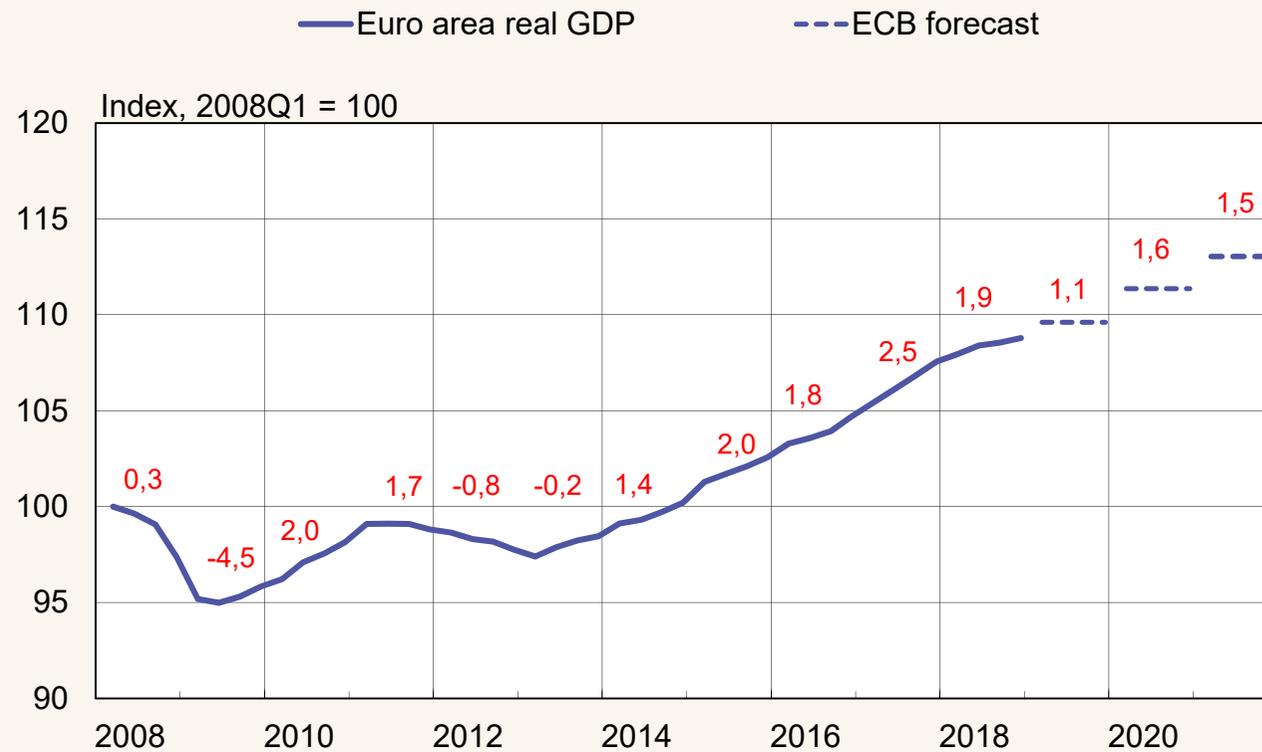
- ECB March 2019 macroeconomic projections
- ECB monetary policy in March 2019
- ECB monetary-policy strategy review



# ECB March 2019 macroeconomic projections



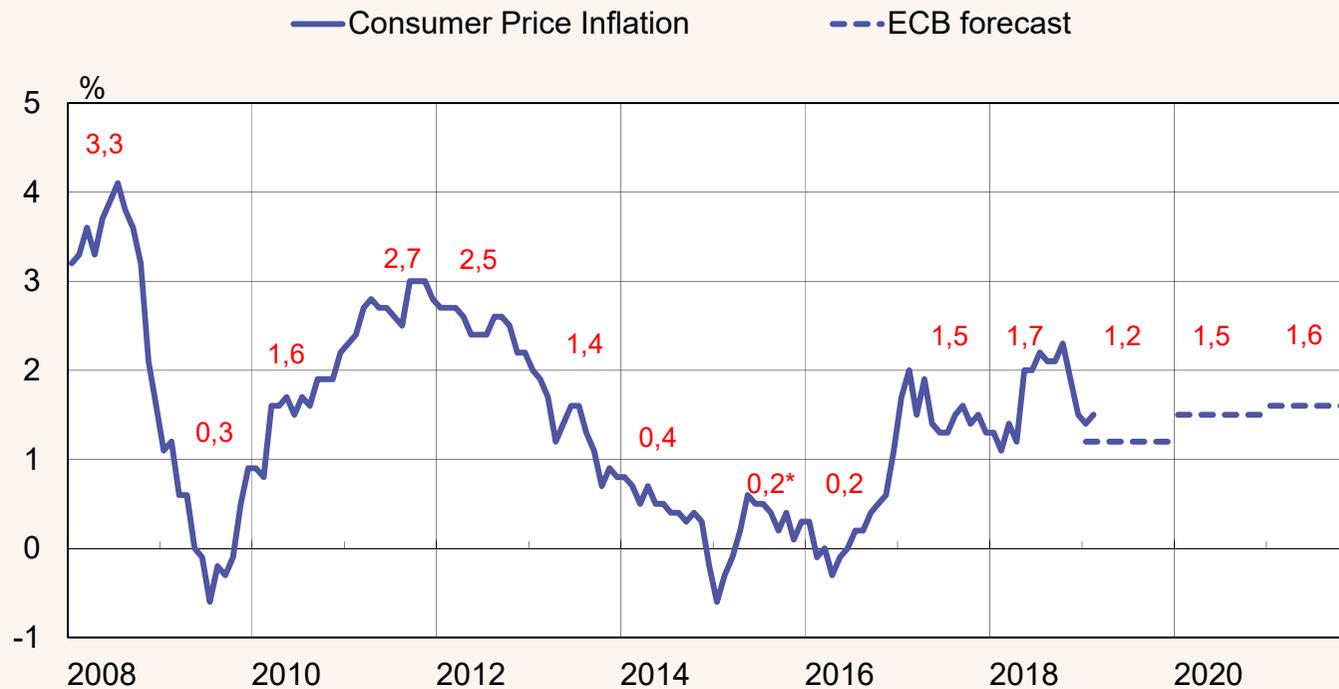
# Euro area gross domestic product 2008–2021



Figures next to the line are annual growth rates.  
Sources: Eurostat and ECB.



# Euro area consumer price inflation 2008–2021



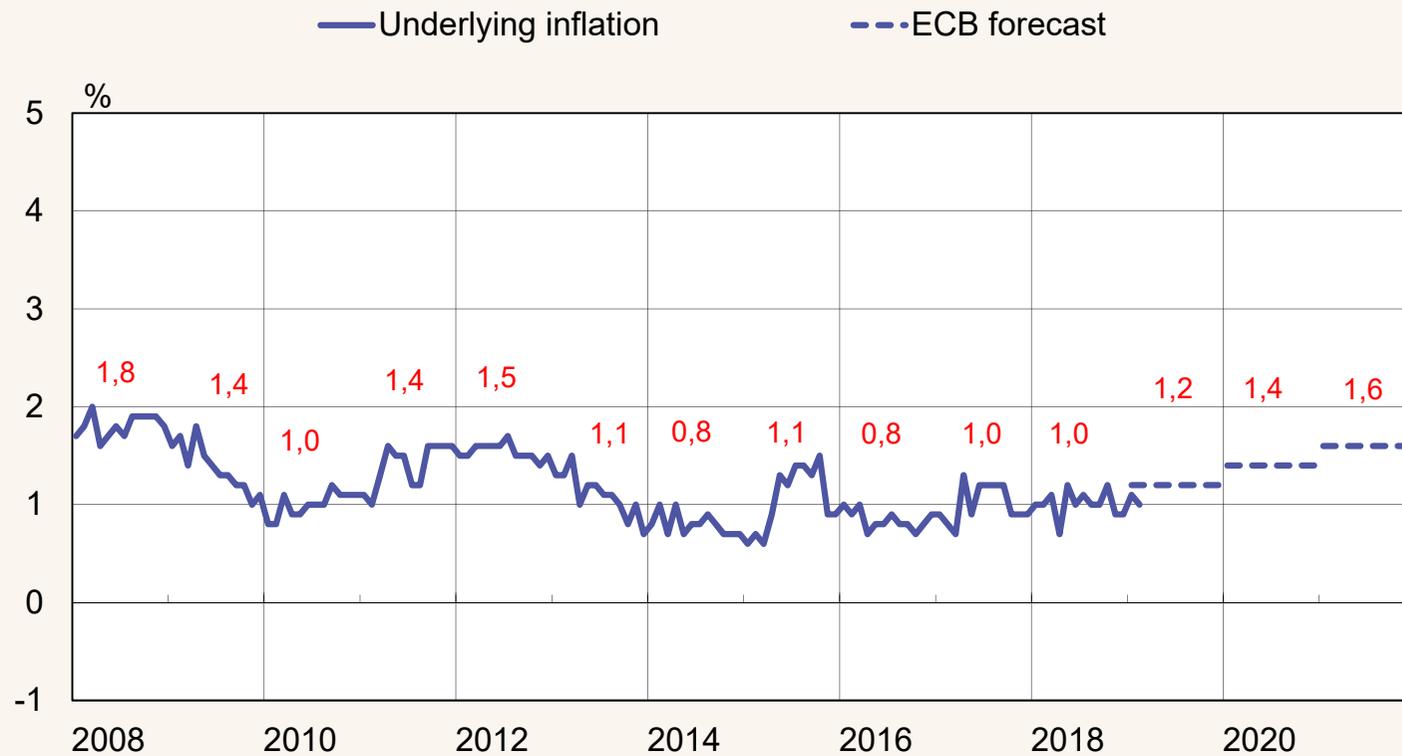
\*Annual inflation rate of 2015 is distorted due to the change in methodology.

Figures above curve are annual growth rates.

Sources: Eurostat and ECB.



# Euro area underlying inflation 2008–2021



Figures above curve are annual growth rates.

Sources: Eurostat and ECB.



# Inflation expectations have faded



Market expectations derived from inflation swaps. SPF = ECB survey of professional forecasters.

Sources: ECB, Bloomberg and calculations by the Bank of Finland.

[eurojatalous.fi](http://eurojatalous.fi) / [bofbulletin.fi](http://bofbulletin.fi)

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## ECB monetary policy in March 2019

The aim of the Governing Council's monetary policy decisions is to ensure the continued sustained convergence of inflation to levels that are below, but close to, 2% over the medium term.



## At its meeting on 7 March 2019, the Governing Council of the ECB took the following monetary policy decisions:

1. The Governing Council now expects **the key ECB interest rates** to remain at their present levels **at least through the end of 2019**, and in any case for as long as necessary to ensure the continued sustained convergence of inflation to levels that are below, but close to, 2% over the medium term.
2. The Governing Council intends to **continue reinvesting, in full**, the principal payments from maturing securities purchased under **the asset purchase programme** for **an extended period of time past** the date when it starts raising the key ECB interest rates, and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation.



## At its meeting on 7 March 2019, the Governing Council of the ECB took the following monetary policy decisions:

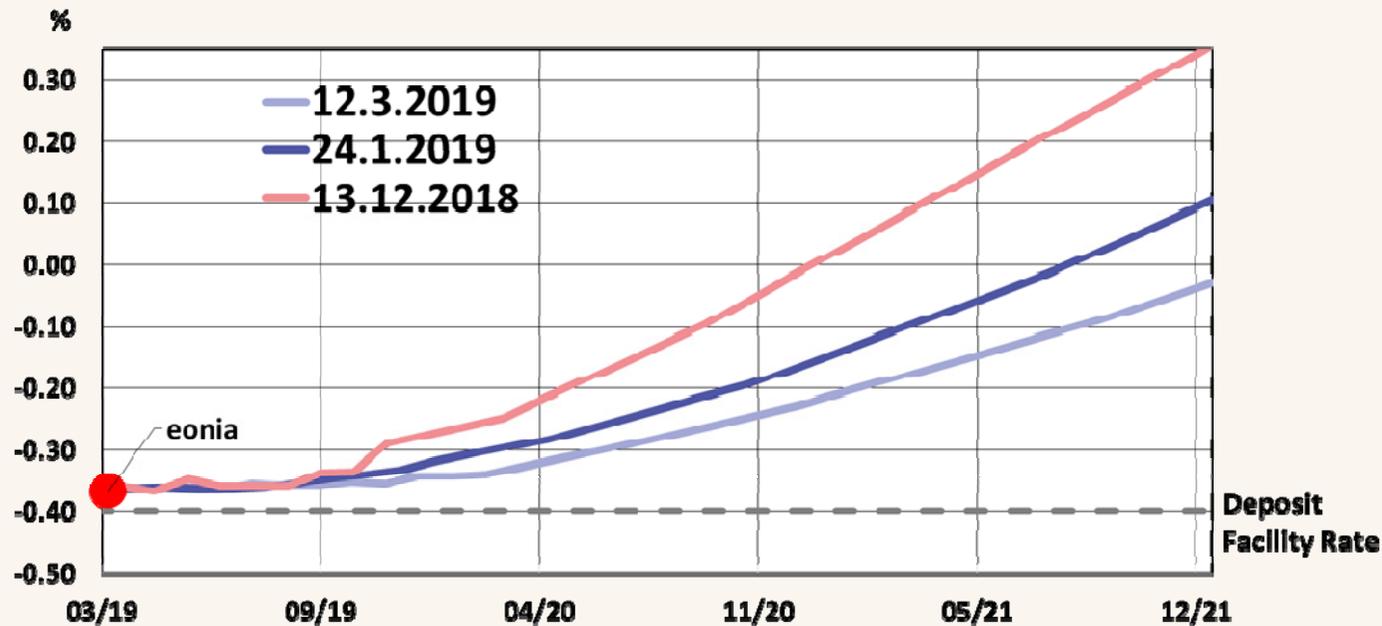
3. In September 2019, a new series of quarterly targeted longer-term refinancing operations (TLTRO-III) will be launched. Operations are to be conducted **until March 2021**. Each operation has a maturity of two years, with the final operation maturing in March 2023.
4. The Eurosystem's lending operations will continue to be conducted **as fixed rate tender procedures with full allotment** at least until March 2021



# ECB monetary policy conducive to growth, employment and price stability



# Market expectations on monetary-policy interest rates have clearly declined from December 2018

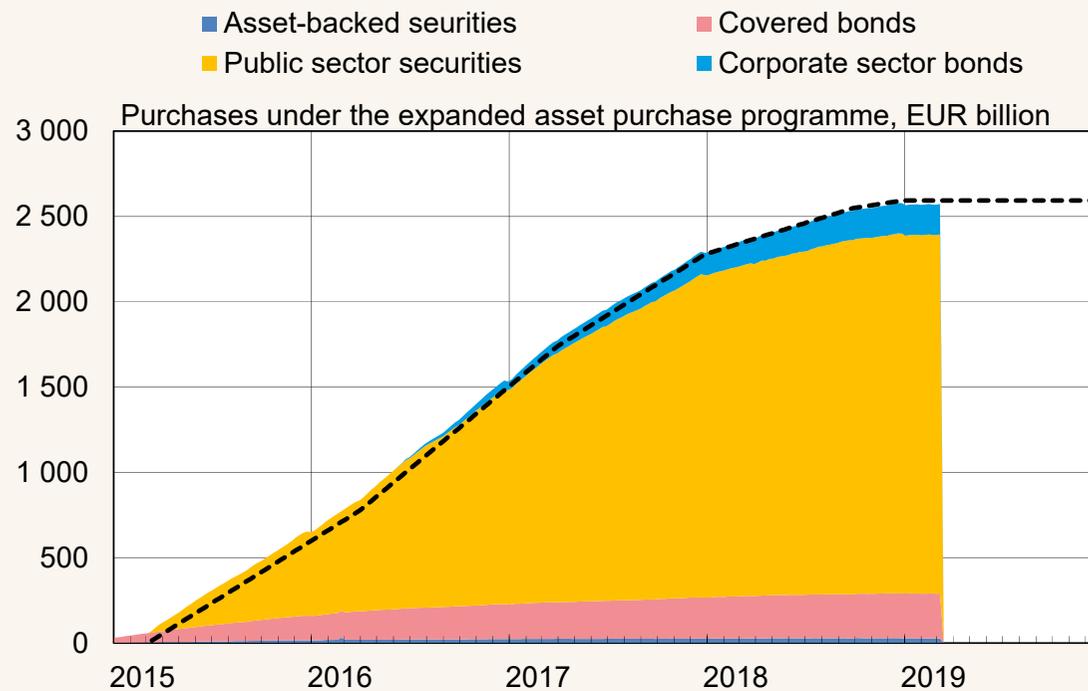


Forward rates based on euro area OIS-rates.

Source: Bloomberg



# Eurosystème purchasing new securities with principal payments from maturing securities



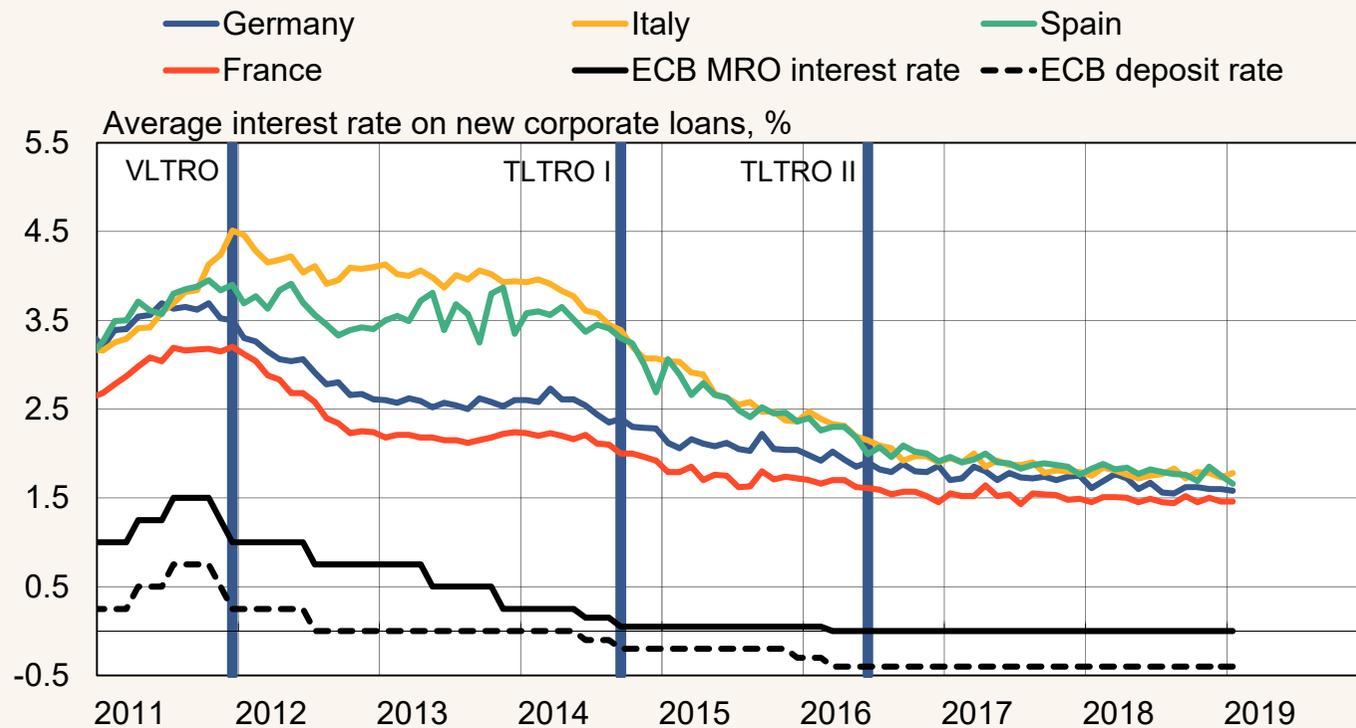
Dashed line refers to the target level announced in June 2018.

Source: ECB.

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# Interest rates on corporate bank loans have fallen significantly in recent years



Sources: ECB and Macrobond.  
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# ECB monetary policy strategy



## Monetary policy strategy under review?

- The last decade has seen fundamental changes in the environment in which central banks operate, due to the financial and sovereign debt crises, population ageing, and the broad decline in interest rates.
- Changes in the operating environment, the experiences of recent years, and new research findings all challenge central banks to review their monetary policy strategies.
- The ECB's monetary policy strategy was last adjusted in 2003 — before the financial crisis and all the subsequent changes in the operating environment.
- The global debate on monetary policy strategies has picked up after a long respite. The Eurosystem, too, should consider a systematic review of its monetary policy framework.



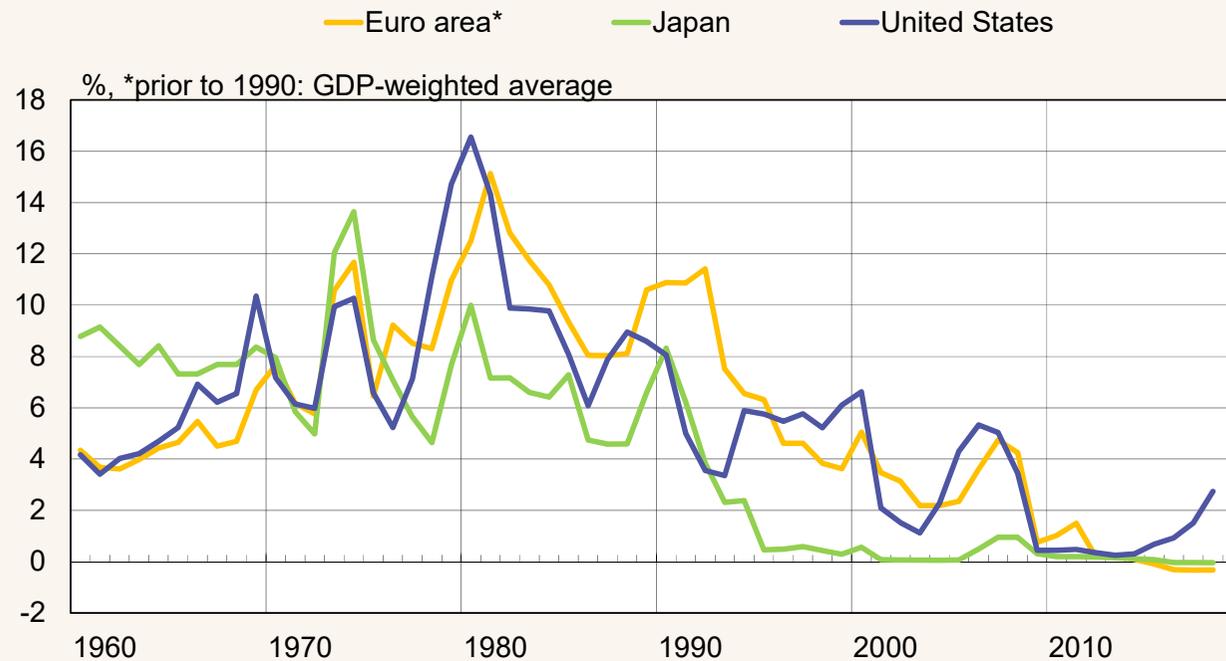
## Strategy review: changes in the operating environment, new research findings

1. Short-term risk-free nominal interest rates at very low levels for a protracted period.
2. Relationship between economic activity and inflation (i.e. Phillips curve) has weakened.
3. Inflation expectations have declined and drifted away from the ECB's definition of price stability (i.e. inflation that is below, but close to, 2%).



# Central banks face an exceptional challenge – the low levels of interest rates

## Short-term interest rates in selected economies



Sources: OECD and European Commission.

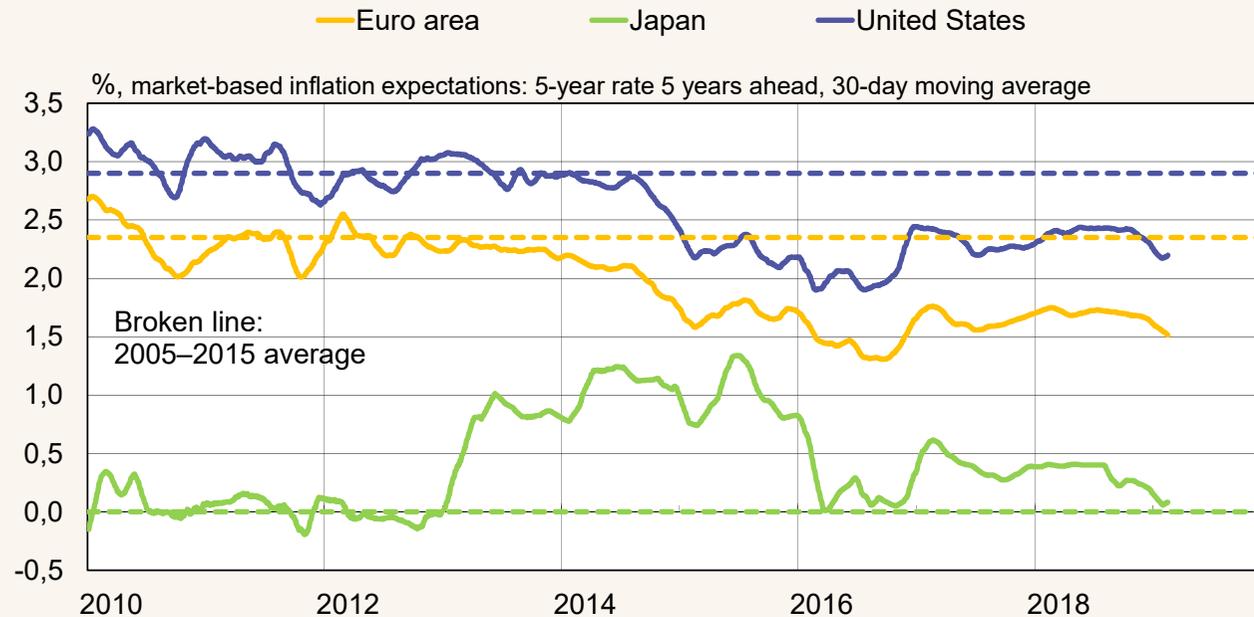
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# Even non-standard policy measures have not pushed up inflation expectations – has monetary policy’s effectiveness dwindled?

Inflation expectations have declined in recent years



Sources: Bloomberg and Bank of Finland.

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## Several reasons for a strategy review

- Together, these three factors support a review of the ECB's monetary policy strategy.
- Naturally, this would not call into question the ECB's primary objective of price stability, but instead entail a thorough assessment of the principles, assumptions and instruments used in the conduct monetary policy.



## Objectives of a strategy review

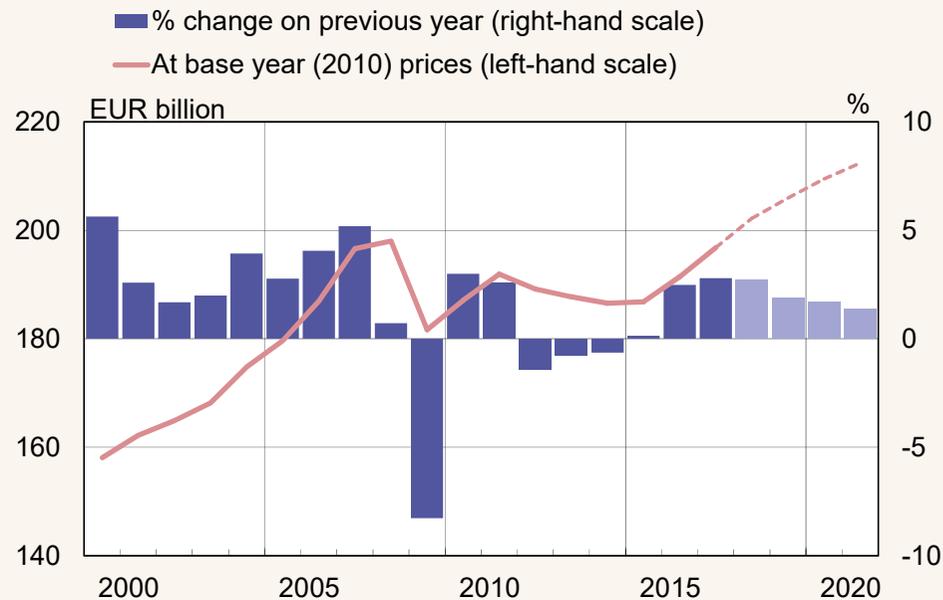
- A key function of the monetary policy framework is to guide expectations of monetary policy and inflation so that they support the achievement of monetary policy objectives — price stability, foremost — even in the current, clearly more challenging environment.
- A solid strategy fulfils this task while supporting monetary policy's ability to stabilise growth of the real economy, thus contributing to sustainable growth and high employment.

***If the strategy review leads to such adjustments that increase the effectiveness and credibility of monetary policy, it will have served its purpose.***



# Growth continues in Finland, but at a slower pace

## Real GDP



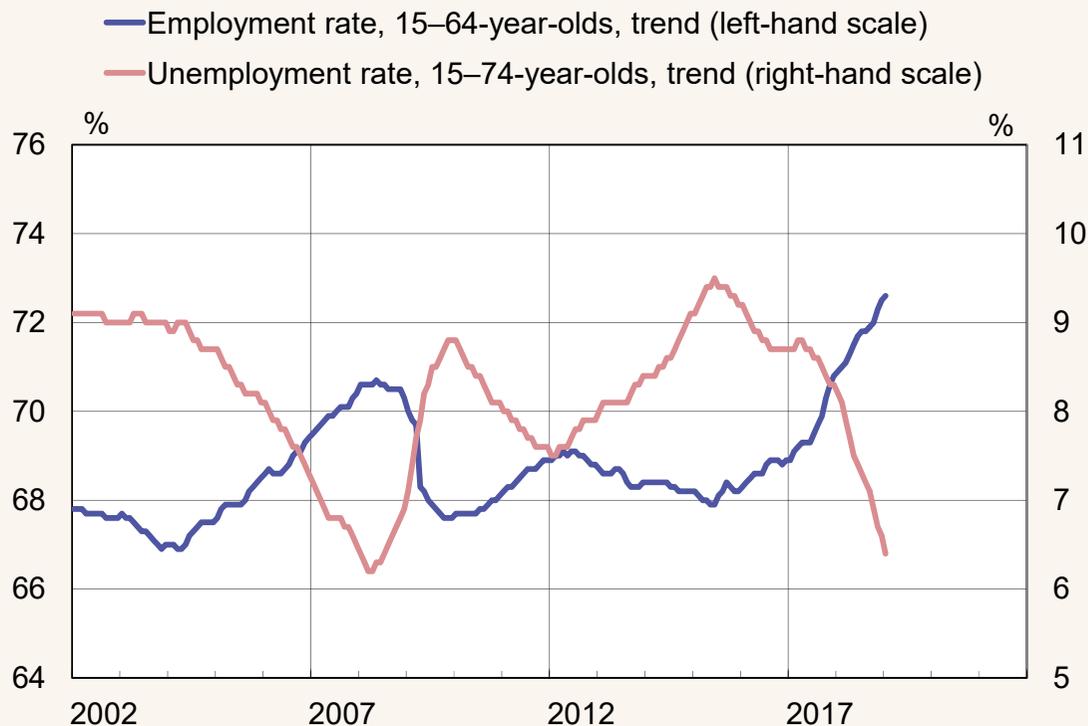
Sources: Statistics Finland and Bank of Finland.

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	BKT, prosenttimuutos	
	Toteutunut	Ennuste, joulukuu 2018
2017	2,7	
2018	2,2	
2019		1,9
2020		1,7
2021		1,4



# Strong growth in employment – target is to reach the Nordic level



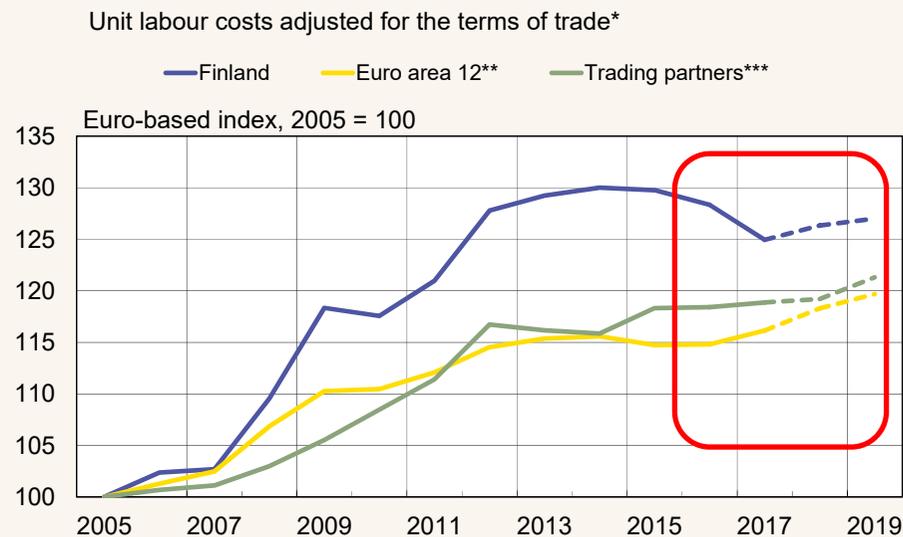
Sources: Statistics Finland and Bank of Finland.

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- Exceptionally strong growth in employment in 2018
- Going forward, employment growth will slow significantly
  - Labour market bottlenecks
  - Mismatch problems
  - Continuing decline in working-age population
- Realistic target: Nordic level >75%



# Cost-competitiveness improved in 2017; likely to improve slightly further in 2018–2019



\*) Compensation per employee relative to national income.  
\*\*) First 12 euro area countries. \*\*\*) 14 traditional industrial countries.  
Forecasts: Bank of Finland (Finland) and European Commission (other countries).  
Sources: Statistics Finland, Bank of Finland and European Commission.

- Cost-competitiveness improved by 6.5% relative to trading partners in 2014–2017
- Subdued labour-cost growth in other countries has dampened the improvement of Finland's relative cost-competitiveness
- This situation may change if wage growth continues in the euro area, despite slower economic growth



## Summary of the Finnish economy in 2019

- Finnish growth has caught up with the rest of the euro area in recent years; the competitiveness of Finnish labour has improved; and employment has strengthened
- But slowing global growth means a weaker outlook for us too — if investment activity in Finland’s main export markets is delayed by uncertainty, Finnish GDP and export growth may come in well below forecasts
- Finland must prepare for a weaker economic cycle, and for the growing need for care services for an ageing population; we must therefore:
  - strengthen the sustainability of our public finances, and
  - raise our employment rate to the Nordic level
- Tomorrow’s challenges here today:
  - productivity growth in the economy
  - sustainable development and climate change

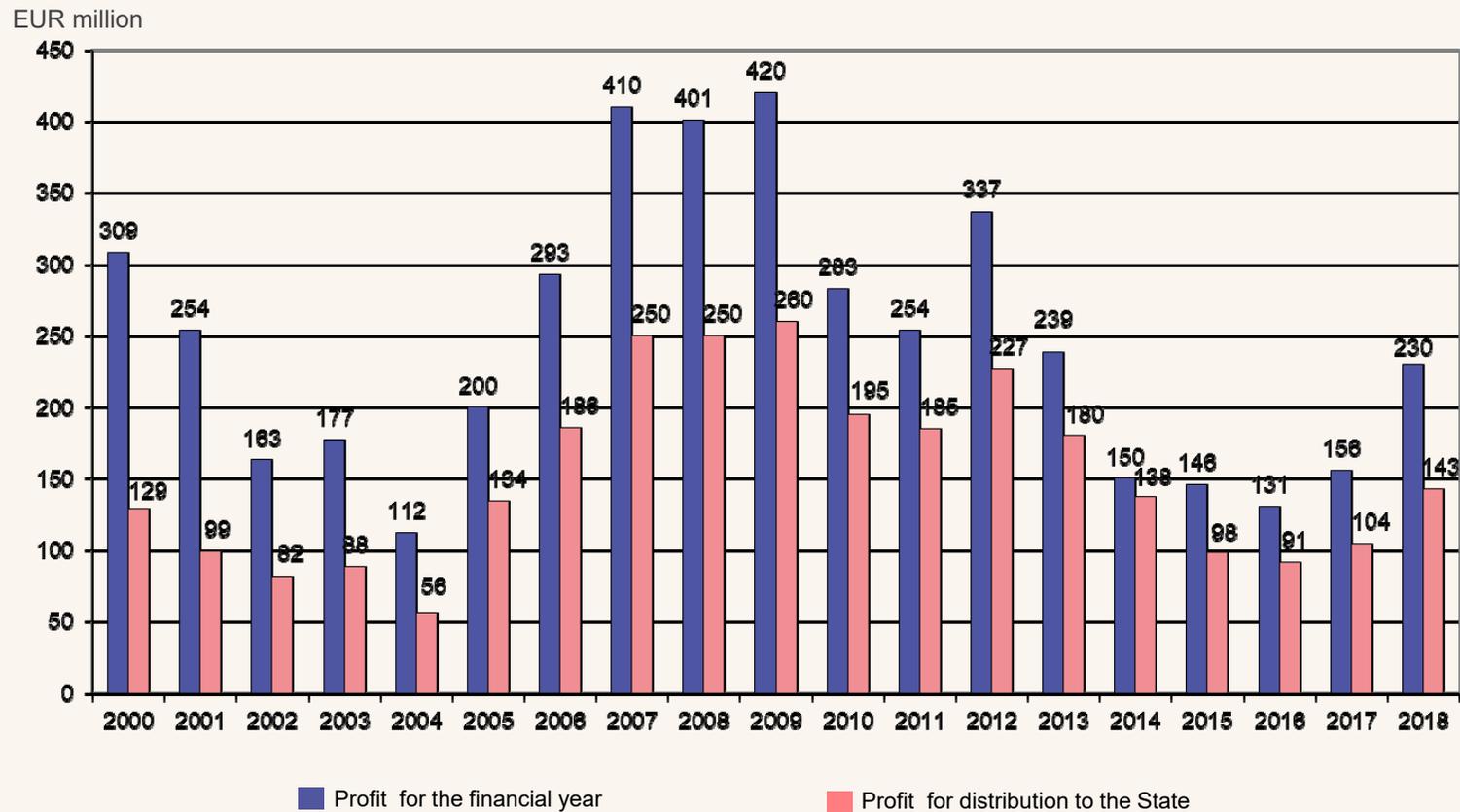


## Bank of Finland's financial result and profit distribution in 2018

- Profit for 2018 totalled EUR 230 million (EUR 156 million in 2017), of which EUR 143 million will be transferred to the State (EUR 104 million in 2017).
- Central banking profit was EUR 410 million and was used to cover the Bank's operating expenses, profit distribution to the State and provisions.
- A provision totalling EUR 2.9 million was established against losses in monetary policy operations. Overall, risk provisions were increased by EUR 65.6 million. The risk buffers ensure the Bank's ability to carry out its tasks.



# Bank of Finland's financial result and distribution of profit to the State, 2000–2018





**Thank you!**